



Continuing The Commitment To Service

Detroit Water & Sewerage Department
Annual Report
For The Fiscal Year Ending June 30, 2005

Independent Auditors' Report

The Board of Water Commissioners,
the Honorable Mayor, and
Members of the City Council
City of Detroit, Michigan:

We have audited the accompanying basic financial statements of the Water Fund (the Fund), an Enterprise fund of the City of Detroit, Michigan (the City), as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting of the Fund. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements referred to above present only the Water Fund of the City of Detroit, Michigan and are not intended to present fairly the financial position of the City of Detroit, Michigan as of June 30, 2005 and 2004, and the changes in its financial position, and, where applicable, cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Fund of the City of Detroit, Michigan as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 31, 2006 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Fund has not presented Management's Discussion and Analysis, which U.S. generally accepted accounting principles have determined is necessary to supplement, although not required to be part of, the basic financial statements.

The schedule of funding progress on page 25 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



March 31, 2006

KPMG LLP, a U.S. limited liability partnership, is the U.S.
member firm of KPMG International, a Swiss cooperative.

CITY OF DETROIT WATER FUND

Statements of Net Assets, June 30, 2005 and 2004

Assets	2005	2004
Current assets:		
Cash	\$ 870,259	3,811,324
Investments	7,520,716	13,491,812
Due from other funds	53,149,298	30,044,331
Accounts receivable (including \$29,934,243 and \$22,755,749, respectively, for unbilled water services and net of allowance for doubtful accounts of \$36,887,901 and \$30,237,264 for June 30, 2005 and 2004, respectively)	68,971,401	64,702,852
Inventories	6,330,165	6,832,006
Prepaid expenses	568,211	106,819
Restricted cash	25,052,140	21,717,159
Restricted investments	412,158,969	273,615,422
Restricted due from other funds	40,475,299	19,027,664
Total current assets	615,096,458	433,349,389
Noncurrent assets:		
Restricted long-term investments	30,072,332	22,769,343
Net pension asset	150,452,508	—
Issuance costs – pension obligation certificates of participation	5,154,834	—
Unamortized bond issuance costs	32,088,822	27,605,624
Capital assets:		
Land and land rights	6,527,438	6,527,438
Structures	707,846,651	453,406,152
Mains	714,856,603	689,057,547
Services, meters, and improvements to land	103,323,777	96,834,157
Equipment	630,635,010	492,782,490
Construction work in progress	418,027,160	679,745,387
Total capital assets	2,581,216,639	2,418,353,171
Less accumulated depreciation	(688,863,364)	(647,652,745)
Net capital assets	1,892,353,275	1,770,700,426
Total noncurrent assets	2,110,121,771	1,821,075,393
Total assets	\$ 2,725,218,229	2,254,424,782

CITY OF DETROIT WATER FUND

Statements of Net Assets, June 30, 2005 and 2004

Liabilities and Net Assets	2005	2004
Current liabilities:		
Accounts and contracts payable	\$ 16,543,893	19,127,419
Accrued salaries and wages	2,171,724	1,817,697
Accrued workers' compensation	3,470,751	4,756,519
Accrued compensated absences	8,604,763	9,984,576
Due to other funds	65,882,639	49,168,308
Other current accrued liabilities	3,053,509	3,068,993
Total current liabilities payable from current assets	99,727,279	87,923,512
Current liabilities payable from restricted assets:		
Revenue bonds payable within one year	24,595,000	22,440,000
Accrued bond interest payable	38,521,332	32,246,376
Accounts and contracts payable	20,117,305	31,321,660
Other current accrued liabilities	629,346	621,531
Due to other funds	6,515,574	7,375,701
Total current liabilities payable from restricted assets	90,378,557	94,005,268
Total current liabilities	190,105,836	181,928,780
Long-term liabilities:		
Revenue bonds payable	1,915,294,379	1,631,424,596
Pension obligation certificates of participation payable	157,548,214	—
Accrued workers' compensation	15,240,595	11,021,735
Accrued compensated absences	9,808,909	5,604,945
Deferred swap termination fees	16,797,795	16,943,863
Total long-term liabilities	2,114,689,892	1,664,995,139
Total liabilities	2,304,795,728	1,846,923,919
Net assets:		
Invested in capital assets, net of related debt	204,520,234	237,151,776
Restricted for capital acquisitions and bond payments	121,409,825	68,734,107
Unrestricted	94,492,442	101,614,980
Total net assets	\$ 420,422,501	407,500,863

See accompanying notes to basic financial statements.

CITY OF DETROIT WATER FUND

Statements of Revenues, Expenses, and Changes in Fund Net Assets, June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Water sales – Detroit	\$ 58,921,494	70,881,142
Water sales – suburban	200,050,339	180,816,226
Miscellaneous	1,641,252	3,719,815
Total operating revenues, net	<u>260,613,085</u>	<u>255,417,183</u>
Operating expenses before depreciation:		
Source of supply	2,244,535	2,599,262
Low-lift pumping	6,081,177	5,628,218
Purification	18,983,784	17,406,399
High-lift pumping	19,338,389	18,614,963
Water quality operations	1,876,012	3,447,504
Transmission and distribution	45,417,478	52,903,044
Services and meters	5,645,086	3,398,813
Hydrant division	1,386,783	246,663
Commercial	7,227,323	6,244,587
Administrative and general	48,753,131	42,072,318
Total operating expenses before depreciation	<u>156,953,698</u>	<u>152,561,771</u>
Operating income before depreciation	103,659,387	102,855,412
Depreciation	<u>41,529,608</u>	<u>38,853,740</u>
Operating income	<u>62,129,779</u>	<u>64,001,672</u>
Nonoperating revenue (expense):		
Earnings on investments	7,175,672	4,223,627
Interest expense, net of capitalized interest	(63,260,449)	(52,210,199)
Miscellaneous	(62,246)	1,039,710
Total nonoperating expense	<u>(56,147,023)</u>	<u>(46,946,862)</u>
Contributed capital	<u>6,938,882</u>	<u>4,038,816</u>
Increase in net assets	<u>12,921,638</u>	<u>21,093,626</u>
Net assets – beginning of year	<u>407,500,863</u>	<u>386,407,237</u>
Net assets – end of year	<u>\$ 420,422,501</u>	<u>407,500,863</u>

See accompanying notes to basic financial statements.

CITY OF DETROIT WATER FUND

Statements of Cash Flows, June 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Receipts from customers	\$ 260,740,367	248,883,564
Internal activity – payments to other funds	(28,698,398)	(30,515,991)
Payments to suppliers	(115,305,031)	(109,534,716)
Payments to the General Retirement System in excess of annual required contributions	(150,452,508)	—
Payments to employees	(53,688,328)	(38,181,938)
Net cash provided by (used in) operating activities	(87,403,898)	70,650,919
Cash flows from noncapital and related financing activities:		
Proceeds from issuance of pension obligation certificates of participation	157,548,214	—
Issuance costs – pension obligation certificates of participation	(5,154,834)	—
Net cash provided by noncapital and related financing activities	152,393,380	—
Cash flows from capital and related financing activities:		
Contributions received from customers	6,938,882	4,038,816
Acquisition and construction of capital assets, net	(134,448,175)	(149,715,214)
Principal paid on revenue bond maturities	(22,440,000)	(19,740,000)
Interest paid on revenue bonds	(85,928,089)	(80,728,302)
Principal paid on refunded debt	(125,985,000)	(226,410,000)
Proceeds from bond issuance and increase in revolving note payable, net	424,791,474	226,410,000
Swap termination fee	—	16,943,863
Other receipts	—	1,039,710
Unamortized discount and bond issuance cost	5,175,110	4,725,892
Net cash provided by (used in) capital and related financing activities	68,104,202	(223,435,235)
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	309,876,577	435,871,559
Purchase of investments	(449,752,017)	(309,876,577)
Interest received on investments	7,175,672	4,223,627
Net cash provided by (used in) investing activities	(132,699,768)	130,218,609
Net increase (decrease) in cash	393,916	(22,565,707)
Cash at beginning of year	25,528,483	48,094,190
Cash at end of year	\$ 25,922,399	25,528,483
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	\$ 62,129,779	64,001,672
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Depreciation	41,529,608	38,853,740
Provision for uncollectible accounts	6,650,637	—
Changes in certain assets and liabilities:		
Increase in accounts receivable	(10,919,185)	(9,800,681)
Decrease in inventories	501,841	622,369
(Increase) decrease in prepaid expenses	(461,392)	428,602
Increase (decrease) in accounts and contracts payable	(13,787,881)	3,912,059
Increase in accrued salaries and wages	354,027	227,029
Increase in net pension asset	(150,452,508)	—
Increase in other accrued liabilities, compensated absences, and workers' compensation	5,749,574	2,922,120
Net change in due to (from) other funds	(28,698,398)	(30,515,991)
Net cash provided by (used in) operating activities	\$ (87,403,898)	70,650,919
Noncash capital financing activities:		

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(1) Summary of Significant Accounting Policies

The City of Detroit (the City) Charter established the Water Department (the Department) in the year 1836 to supply water within and outside the City under the administration of the Board of Water Commissioners. The Water Fund (the Fund), an Enterprise fund, separately accounts for the Water Supply System (the System), as is required by bond ordinances of the City. The following is a summary of the more significant accounting policies followed in the preparation of the Fund's financial statements. These policies conform to U.S. generally accepted accounting principles.

The financial statements of the Water Fund have been included in the City of Detroit's Comprehensive Annual Financial Report (CAFR) and reported as an Enterprise fund. Copies of these reports, along with other financial information, can be obtained at the Fund's administrative office, located at 735 Randolph, Detroit, Michigan, 48226.

(a) Basis of Accounting

The accounting policies of the Fund conform to U.S. generally accepted accounting principles (GAAP) as applicable to governmental entities. The accounts of the Fund, which are organized as an Enterprise fund, are used to account for the Fund's activities, which are financed and operated in a manner similar to a private business enterprise. Accordingly, the Fund maintains its records on the accrual basis of accounting. Revenues from operations, investments, and other sources are recorded when earned. Expenses (including depreciation and amortization) of providing services to the public are accrued when incurred.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Fund applies all applicable GASB pronouncements, as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB

pronouncements. The Fund also has the option of following FASB guidance issued after November 30, 1989, but has elected not to do so.

(b) Cash and Cash Equivalents

Cash and cash equivalents consist of "cash" as on deposit in financial institutions, including restricted assets.

(c) Investments

Investments are reported at fair value based on quoted market price.

(d) Inventories

Inventories consist of operating and maintenance and repair parts for water lines and are valued at the lower of cost or market, with cost being determined on a first-in, first-out (FIFO) basis.

(e) Capital Assets

Capital assets are recorded at historical cost, together with interest capitalized during construction. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets as follows:

Improvements to land	67 years
Structures	40 years
Mains	67 years
Services	67 years
Meters and equipment	3 – 20 years

(f) Workers' Compensation

The Fund has no insurance coverage for workers' compensation claims. Workers' compensation expenses are recorded when the occurrence of the liability is probable and the amount is reasonably estimable. The amounts recorded as of June 30, 2005 and 2004 are based on compensation expected to be paid, along with estimated medical costs, for all claims known as of the balance sheet date, and historical data are used in computing the liability for estimated incurred but unreported claims as of the balance sheet date.

(f) - Workers' Compensation Changes in the liability since June 30, 2003 are summarized as follows:

		June 30		
		2005	2004	2003
Balance at beginning of year	\$	15,778,254	13,778,575	17,371,414
Current year claims and changes in estimates		7,345,178	6,756,198	1,016,096
Claims payments		(4,412,086)	(9,168,605)	(4,608,935)
Balance at end of year	\$	<u>18,711,346</u>	<u>11,366,168</u>	<u>13,778,575</u>

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(g) Capitalized Interest

The Fund capitalizes qualifying net interest costs of the System on bonds issued for capital construction in accordance with Statement of Financial Accounting Standards Nos. 34 and 62. Accordingly, capitalized interest for the years ended June 30, 2005 and 2004 was \$28,942,595 and \$26,713,603, respectively.

(h) Taxes and City Services

The Fund pays no direct federal, state, or local taxes, except local taxes on excess property and federal Social Security taxes. The Fund reimburses the City for most of the direct services furnished by other City departments, including general staff services. Charges are billed for all water services provided to City departments.

(i) Shared Costs

Costs related to shared facilities and personnel are allocated to the Fund on a basis that relates costs incurred to the fund benefited.

(j) Compensated Absences

The Fund records as a liability estimated vested vacation, sick pay, and banked overtime in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Unused vacation pay accumulates until termination of employment, while there is no vesting of sick pay until an employee reaches age 60 or completes 25 years of service.

(k) Accrued Revenue

The Fund records unbilled revenues for services provided prior to year-end by accruing actual revenues billed in the subsequent month.

(l) Net Assets

Net assets are categorized as follows:

Invested in capital assets: This consists of capital assets, net of accumulated depreciation and related debt.

Restricted: This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the City's policy to use restricted resources first, and then unrestricted resources when they are needed.

Unrestricted: This consists of net assets that do not meet the definition of "restricted" or "invested in capital assets."

(m) Classification of Revenues

The Fund has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues: Operating revenues include activities that have the characteristics of exchange transactions, such as revenue from charges for water service.

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, which are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34, such as investment income and interest expense.

(n) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(o) New Accounting Pronouncements

The Fund adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an Amendment of GASB Statement No. 3*, for the year ended June 30, 2005. This pronouncement requires additional disclosures presented in these notes, but has no impact on the net assets of the fund. These disclosures address common deposit and investment risks related to credit risk, concentration of credit risk, interest risk, and foreign currency risk. GASB 40 does not address the retroactive applicability of required disclosures, and, except for custodial credit risk, the Fund did not disclose deposit and investment risks at June 30, 2004.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets. The City will implement Statement No. 42 beginning with the year ended June 30, 2006. The City is currently evaluating the impact of adopting Statement No. 42.

In July 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes accounting and financial reporting standards for employers that participate in a defined-benefit "other postemployment benefit" (OPEB) plan. The City will implement Statement No. 45 beginning with the year ended June 30, 2006. The City is currently evaluating the impact of adopting Statement No. 45.

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(2) Deposits and Investments

The following is a complete listing of deposits and investments held by the City at June 30, 2005:

Deposits	\$	34,459,813
Investments		<u>441,214,603</u>
Total deposits and investments	\$	<u>475,674,416</u>

The deposits and investments of the City at June 30, 2005 are reflected in the financial statements as follows:

Unrestricted:		
Cash	\$	870,259
Investments		<u>7,520,716</u>
Restricted:		
Cash		25,052,140
Investments – current		412,158,969
Investments – noncurrent		<u>30,072,332</u>
Total cash and investments	\$	<u>475,674,416</u>

State law authorizes the City to make deposits in the accounts of federally insured financial institutions. Cash held by fiscal agents or by trustees is secured in accordance with the requirements of the agency or trust agreement.

The City is authorized to invest in obligations of the U.S. government or its agencies, certificates of deposit, savings and depository accounts of insured institutions, commercial paper of certain investment quality, repurchase agreements, banker's acceptances, mutual funds of certain investment quality, and investment pools as authorized by state law.

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of bank failure, the Fund's deposits may not be returned by the bank. The City does not have a deposit policy for custodial credit risk. At June 30, 2005 and 2004, the Fund had deposits of \$27,464,345 and \$25,286,869, respectively,

that were exposed to custodial credit risk, as they were uninsured and uncollateralized.

Custodial Credit Risk of Investments

Custodial credit risk is the risk that in the event of failure of the counterparty, the Fund will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City does not have a policy for custodial credit risk. As of June 30, 2005 and 2004, the Fund had no investments subject to custodial credit risk.

Interest Rate Risk

Interest rate risk is the risk that, over time, the value of investments will decrease as a result of a rise in interest rates. The City's investment policy does not specifically restrict investment maturities other than commercial paper, which can only be purchased with a 270-day maturity. The City's policy minimizes interest rate risk by requiring that the Fund attempt to match its investments with anticipated cash flow requirements. Unless related to a specific cash flow, the City is generally not permitted to directly invest in securities maturing more than 10 years from the original date of purchase. See chart below.

Credit Risk

The City of Detroit's investment policy complies with state law. The City limits its investments in commercial paper, mutual funds, and external investment pools that purchase commercial paper to the top two rating classifications issued by two nationally recognized statistical rating organizations (NRSROs). See chart on page 24.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the Fund's investment in a single issuer. The City's policy specifies a number of limitations to minimize concentration of credit risk, including prohibiting investing more than 5% of the portfolio in securities (other than U.S. government, mutual funds, external investment pools, and other pooled investments) of any one issuer.

More than 5% of the Fund's investments are in Federal Home Loan Bank, Federal Home Loan Mortgage, and Federal National Mortgage Association securities. These investments are 8%, 8%, and 15.7%, respectively, of the Fund's total investments.

(2) - Interest Rate Risk

Investment	Fair value	Investment maturities in years
		Less than one year
U.S. government agency securities	\$ 139,813,096	139,813,096
Repurchase agreements	23,442,000	23,442,000
Money market	<u>277,959,507</u>	<u>277,959,507</u>
Total investments	\$ <u>441,214,603</u>	<u>441,214,603</u>

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(2) - Credit Risk as of June 30, 2005, the Fund had the following investments, maturities, and credit quality ratings of debt securities:

Investment	Fair value	Rating	Rating organization
U.S. government agency securities	\$ 104,634,194	AAA	S&P
U.S. government agency securities	35,178,902	Aaa	Moody's
Repurchase agreements	23,442,000	AAA	S&P
Money market	1,014,385	Aa3	Moody's
Money market	276,945,122	Not rated	N/A
Total investments	\$ 441,214,603		

(3) Restricted Assets

Restricted assets, principally cash and investments, are available for debt service on revenue bonds and to provide funds for improvements, enlargements, extensions, and construction. In certain instances, minimum levels of assets are required by bond ordinance provisions or by Board of Water Commissioners decree. These assets are maintained as follows: (1) With respect to the Bond and Interest Redemption Fund, after provision has been made for expenses of operation and maintenance of the System, a sum proportionately sufficient to provide for payment, when due, of the current principal and interest is set aside. The Bond Reserve Account is part of the Bond and Interest Redemption Fund, and the amounts credited to this account are to be used only to pay principal and interest on the bonds when current revenues are not sufficient. (2) With respect to the Extraordinary Repair and Replacement Reserve Fund, after meeting the requirements of the foregoing funds, monthly deposits in an amount equal to one twelfth of 3% of the budgeted operation and maintenance expense of the System for the fiscal year must be set aside until the aggregate amount funded totals at

least 15% of that year's budgeted operating and maintenance costs. These deposits are to be used for major unanticipated repairs and replacement to the System with actual or anticipated cost exceeding \$1 million. Once this fund is fully funded, deposits required are amounts needed to maintain fully funded status. Borrowings of up to 50% of the balance in this fund on the first day of the related fiscal year are allowed for transfer to and use from the Improvement and Extension Fund. Any such borrowings must be repaid prior to any deposits being made to the Improvement and Extension Fund. (3) After the above deposits have been made, excess amounts may be deposited in the Improvement and Extension Fund, established for the payment of improvements, enlargements, repairs, extensions, or betterment to the System. (4) With respect to the Construction Fund, the portion of the proceeds of the sale of bonds for building or improving the System is deposited in this fund. A separate depository account is required for each series of bonds. Proceeds for construction purposes received from federal and state grants and other sources that restrict the use of such proceeds are also deposited into this account.

(4) - Capital Assets

Capital asset activity for the fiscal years ended June 30, 2005 and 2004 is as follows:

	Balance, June 30, 2004	Additions	Disposals	Balance, June 30, 2005
Nondepreciated capital assets:				
Land and land rights	\$ 6,527,438	—	—	6,527,438
Construction in progress	679,745,387	171,715,631	(433,433,858)	418,027,160
	686,272,825	171,715,631	(433,433,858)	424,554,598
Depreciated capital assets:				
Services, meters, and improvements to land	96,834,157	6,489,620	—	103,323,777
Structures	453,406,152	254,440,499	—	707,846,651
Mains	689,057,547	25,799,056	—	714,856,603
Equipment	492,782,490	138,004,268	(151,748)	630,635,010
Accumulated depreciation	(647,652,745)	(41,529,608)	318,989	(688,863,364)
	1,084,427,601	383,203,835	167,241	1,467,798,677
Total	\$ 1,770,700,426	554,919,466	(433,266,617)	1,892,353,275

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(4) - Capital Assets

Capital asset activity for the fiscal years ended June 30, 2005 and 2004

	Balance, June 30, 2003	Additions	Disposals	Balance, June 30, 2004
Nondepreciated capital assets:				
Land and land rights	\$ 6,358,342	169,096	—	6,527,438
Construction in progress	608,364,217	157,981,415	(86,600,245)	679,745,387
	<u>614,722,559</u>	<u>158,150,511</u>	<u>(86,600,245)</u>	<u>686,272,825</u>
Depreciated capital assets:				
Services, meters, and improvements to land	91,118,140	5,716,017	—	96,834,157
Structures	431,915,880	21,490,272	—	453,406,152
Mains	672,467,862	16,688,484	(98,799)	689,057,547
Equipment	432,868,661	61,097,286	(1,183,457)	492,782,490
Accumulated depreciation	<u>(609,967,751)</u>	<u>(38,853,740)</u>	<u>1,168,746</u>	<u>(647,652,745)</u>
	<u>1,018,402,792</u>	<u>66,138,319</u>	<u>(113,510)</u>	<u>1,084,427,601</u>
Total	<u>\$ 1,633,125,351</u>	<u>224,288,830</u>	<u>(86,713,755)</u>	<u>1,770,700,426</u>

(5) Revenue Bonds

The outstanding indebtedness of the Fund for revenue bonds was approximately \$1,991,615,000 and \$1,713,435,000 at June 30, 2005 and 2004, respectively. The interest rates on the outstanding fixed-rate revenue bonds range from 4.30% to 6.38%. Net revenues of the Fund are pledged to repayment of bonds. See chart below.

In fiscal 2005, the Fund issued \$105,000,000 of City of Detroit, Michigan, Water Supply System Revenue Senior Lien Bonds, Series 2005-A; \$195,000,000 of City of Detroit, Michigan, Water Supply System Revenue Refunding Second Lien Bonds (Variable Rate Demand), Series 2005-B; and \$126,605,000 of City of Detroit, Michigan, Water Supply System Revenue Refunding Senior Lien Bonds, Series 2005-C. The net proceeds were used to refund a

portion of the City's outstanding Water Supply System Revenue Bonds and Revenue Refunding Bonds and to pay costs of issuance associated with the 2005 Bonds.

The net proceeds of the Water Supply System Revenue Second Lien Bond, Series 2005-A, of \$97,314,500 (net of capitalized interest of \$8,611,516 and bond underwriting fees, insurance, and other issuance costs of \$2,119,542) were used to purchase U.S. government securities.

The net proceeds of the Water Supply System Revenue Senior Lien Bond (Variable Rate Demand), Series 2005-B, of \$176,783,879 (net of capitalized interest of \$16,096,578 and underwriting fees, insurance, and other issuance costs of \$2,119,542) were used to purchase U.S. government securities.

(5) - Revenue Bonds

Future debt service requirements as of June 30, 2005

	Principal	Bond interest	Swap interest	Total requirements
Year ending June 30:				
2006	\$ 24,595,000	74,448,987	15,613,926	114,657,913
2007	25,535,000	77,090,942	16,226,702	118,852,644
2008	25,970,000	75,971,524	16,165,021	118,106,545
2009	35,070,000	74,601,362	16,090,087	125,761,449
2010	34,655,000	73,055,802	16,022,413	123,733,215
2011 – 2015	211,425,000	341,202,737	70,264,121	622,891,858
2016 – 2020	261,685,000	293,082,075	60,305,668	615,072,743
2021 – 2025	318,665,000	243,714,969	45,142,735	607,522,704
2026 – 2030	427,670,000	176,140,494	28,687,150	632,497,644
2031 – 2035	504,765,000	68,708,680	20,125,093	593,598,773
2036 – 2040	<u>121,580,000</u>	<u>1,462,380</u>	<u>1,393,605</u>	<u>124,435,985</u>
	<u>\$ 1,991,615,000</u>	<u>1,499,479,952</u>	<u>306,036,521</u>	<u>3,797,131,473</u>

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

The proceeds of the Revenue Refunding Senior Lien Bonds, Series 2005-C, will be used (a) to advance-refund the \$69,285,000 principal amount of the City's Water Supply Revenue Senior Lien Bonds, Series 1997-A, comprising serial bonds maturing in the years 2010, 2016, and 2017; the 2018 through 2021 mandatory redemption payment for serial 1997-A term bonds, maturing July 1, 2027 (the Refunded 1997-A Bonds), with an average interest rate of 5.5%; (b) to refund the \$56,700,000 principal amount of the City's Water Supply System Revenue Senior Lien Bonds, Series 1999-A, bonds maturing in the years 2011 through 2018 with interest rate of 7.48% (the Refunded 1999-A Bonds and, collectively with the Refunded 1997-A Bonds, the Refunded Bonds); and (c) for payment of the related costs of issuance, including the premium for the municipal bond insurance.

Those refunded securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Refunded 1999-A Bonds when due to and including July 1, 2010 and redeem the Refunded 1997-A Bonds on July 1, 2007 at 101%.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$5,640,081. This difference, reported in the financial statements as a deduction from bonds payable, is being charged to operations through the year 2024 using the straight-line method. The Fund completed the advance refunding to reduce its total debt service payments over the next 20 years and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$4,567,184.

In prior years, the Fund defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Fund's financial statements. Similarly, the interest expenses related to the defeased bonds and the related interest

income earned on the escrow fund investments have not been recognized in the statements of revenues, expenses, and changes in fund net assets. As of June 30, 2005 and 2004, approximately \$511,265,000 and \$546,360,000, respectively, of bonds outstanding are considered defeased.

Bonds outstanding at June 30, 2005 include \$1,792,485,000 of bonds callable at various dates after June 30, 2005. These bonds are callable at varying premiums, depending on the issue and length of time to maturity.

Subsequent to year-end, the Fund received loans from the Michigan Municipal Bond Authority Michigan State Revolving Loan Fund Program in the amount of \$25,975,000 for the construction of facilities.

(6) Issuance of Pension Obligation Certificates

On June 2, 2005, the Detroit Retirement Systems Funding Trust issued \$1.44 billion (\$640 million of taxable fixed-rate Series A and \$800 million of taxable floating-rate Series B) of taxable pension obligation certificates of participation (POCs). The Trust was created by the Detroit General Retirement System Service Corporation (DGRSSC) and the Detroit Police and Fire Retirement System Service Corporation (DPFRSSC), both blended component units of the City. The City entered into service contracts with the DGRSSC and the DPFRSSC to facilitate the transaction. The POCs represent undivided proportionate interests in the rights to receive the payments from the City under its service contracts with the DGRSSC and the DPFRSSC.

The POCs were issued for the purpose of funding certain unfunded accrued actuarial liabilities (UAAL) of the two retirement systems of the City, which include the General Retirement System (GRS) and the Police & Fire Retirement System (PFRS). The UAAL is a liability of the City for past services rendered by its employees in which Michigan state law and the Michigan Constitution require that a

(6) Issuance of Pension Obligation Certificates

	Principal amounts	Interest	Total
Year ending June 30:			
2006	\$ —	5,461,769	5,461,769
2007	3,236,054	7,741,123	10,977,177
2008	3,961,650	7,598,639	11,560,289
2009	4,774,304	7,422,332	12,196,636
2010	5,641,106	7,208,619	12,849,725
2011 – 2015	43,859,779	31,285,264	75,145,043
2016 – 2020	54,426,291	18,149,587	72,575,878
2021 – 2025	41,649,030	7,104,735	48,753,765
Total	\$ 157,548,214	91,972,068	249,520,282

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

portion be annually paid. The GRS includes employees and retirees of certain Enterprise funds, including the Water Fund.

A total \$157,548,214 of the \$1,440,000,000 of POCs issued is attributable and allocated to the Water Fund. The amount of \$5,144,834 relates to issuance costs that are recorded as an asset and will be amortized over 20 years, the life of the POCs; \$152,393,380 of the proceeds were contributed to the GRS, which included \$1,940,872 of annual required contributions for June 30, 2005. The remaining amount of \$150,452,508 resulted in a net pension asset.

Interest payments for Series A will commence on December 15, 2005 and are due semiannually, while the first principal payment is payable June 15, 2007, due annually, and is payable through 2025. Interest payments for Series B will commence on September 15, 2005 and are due quarterly through 2025, while the first principal payment is payable June 15, 2007, due annually, and is payable through 2025. The interest rates on the outstanding obligations range from 4.004% to 4.948%.

The redemption dates and aggregate principal and interest amounts for such redemption dates. See chart on page 26.

(7) Deferred Swap Termination Proceeds

During the year ended June 30, 2004, the Fund and its counterparty terminated a forward starting swap agreement related to the future issuance of debt in fiscal year 2005. The Fund received a termination payment in the amount of

\$16,943,863 that was deferred to offset future debt service. The proceeds will be recognized over the life of the debt that was issued in fiscal year 2005 using the straight-line method.

For the year ended June 30, 2005, \$146,068 was recognized as a reduction of interest expense, leaving a remaining balance of \$16,797,795 at June 30, 2005.

(8) Long-Term Liabilities

Long-term activity for the years ended June 30, 2005 and 2004. See chart below and on page 28..

(9) Derivatives Not Reported at Fair Value

The Fund is party to derivative financial instruments consisting of interest rate swaps that are intended to effectively convert variable-rate financings to fixed-rate financings. These are not reported at fair value on the statement of net assets at June 30, 2005.

Objective of the swaps. In order to better manage its interest rate exposure and to reduce the overall costs of its financings, the Fund has entered into 15 separate fixed-payor interest rate swaps.

Market access risk. The Fund is exposed to market access risk on its hedge swaps or forward starting swaps in the event that it will not be able to enter credit markets or in the event that credit will become more costly.

Terms, fair values, and credit risk. Certain key terms, fair market values, and counterparty credit ratings relating to

(8) - Long-Term Liabilities

	Balance, June 30, 2004	Increase	Decrease	Balance, June 30, 2005	Amount due within one year
Revenue bonds payable	\$ 1,713,435,000	426,605,000	(148,425,000)	1,991,615,000	24,595,000
Add:					
Unamortized premium	6,257,305	12,302,729	(583,344)	17,976,690	—
Less:					
Deferred charges on refunding	44,223,565	8,298,346	(3,297,934)	49,223,977	—
Discount	21,604,144	—	(1,125,810)	20,478,334	—
Net revenue bonds	1,653,864,596	430,609,383	(144,584,600)	1,939,889,379	24,595,000
Pension obligation certificates payable	—	157,548,214	-	157,548,214	—
Other liabilities:					
Accrued workers' compensation	15,778,254	7,345,178	(4,412,086)	18,711,346	3,470,751
Accrued compensated absences	15,589,521	4,203,964	(1,379,813)	18,413,672	8,604,763
Deferred swap termination	16,943,863	—	(146,068)	16,797,795	—
Total other liabilities	48,311,638	11,549,142	(5,937,967)	53,922,813	12,075,514
Total	\$ 1,702,176,234	599,706,739	(150,522,567)	2,151,360,406	36,670,514

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(8)b - Long-Term Liabilities

	Balance, June 30, 2003	Increase	Decrease	Balance, June 30, 2004	Amount due within one year
Revenue bonds payable	\$ 1,718,985,000	240,600,000	(246,150,000)	1,713,435,000	22,440,000
Add:					
Unamortized premium	6,734,590	—	(477,285)	6,257,305	—
Less:					
Deferred charges on refunding	35,530,436	12,954,628	(4,261,500)	44,223,564	—
Discount	22,729,954	562,590	(1,688,400)	21,604,144	—
Net revenue bonds	1,667,459,200	227,082,782	(240,677,385)	1,653,864,597	22,440,000
Other liabilities:					
Accrued workers' compensation	13,778,575	6,756,198	(4,756,519)	15,778,254	4,756,519
Accrued compensated absences	13,925,849	1,810,212	(146,540)	15,589,521	9,984,576
Deferred swap termination	—	16,943,863	—	16,943,863	—
Total other liabilities	27,704,424	25,510,273	(4,903,059)	48,311,638	14,741,095
Total	\$ 1,695,163,624	252,593,055	(245,580,444)	1,702,176,235	37,181,095

the outstanding swaps as of June 30, 2005 are presented below. The notional amounts of the swaps, except those with effective dates of September 1, 2006 and March 1, 2007, match the principal amounts of the outstanding financings. The swaps with effective dates of September 1, 2006 and March 1, 2007 were entered into to hedge future interest rate risk and will be associated with financings expected to be issued prior to the effective dates. Except as discussed under rollover risk, the Fund's swap agreements contain scheduled reductions to outstanding notional amounts that match scheduled or anticipated amortization of associated financings. See chart below.

Fair value. Because interest rates have generally declined since the time the swaps were negotiated, most of the Fund's swaps have a negative fair value as of June 30,

2005. The negative fair values may be countered by lower total interest payments required under the variable-rate financings, creating lower synthetic interest rates.

Credit risk. As of June 30, 2005, the Fund was not significantly exposed to net credit risk, as the majority of the swaps had net negative fair values. However, should interest rates change and fair values of the swaps become positive, the Fund would be exposed to credit risk in the amount of the derivatives' positive fair value.

The swap agreements contain varying collateral agreements with the counterparties. The swaps require full collateralization of the fair value of the swap should the counterparty's credit rating fall below certain rating levels by Fitch Ratings, Standard & Poor's, and/or Moody's

(9) - Derivatives Not Reported at Fair Value

Associate d financing issue	Notional amounts (1)	Effective date	Fixed rate paid	Variable rate received	Fair values	Sweep termination date	Final maturity of bonds	Counterparty credit rating
Water 2001-C (3)	\$ 47,723,000	6/7/2001	4.07%	BMA (2)	\$ (699,037)	1/1/2006	7/1/2029 (3)	Aaa/AA+NR
Water 2001-C (3)	30,032,000	6/7/2001	4.70	BMA	(2,620,915)	7/1/2011	7/1/2029 (3)	Aaa/AA+NR
Water 2001-C (3)	47,628,000	1/1/2006	5.42	BMA	(4,882,486)	7/1/2011	7/1/2029 (3)	Aaa/AA+NR
Water 2001-C	114,150,000	6/7/2001	4.90	BMA	(20,866,778)	7/1/2026	7/1/2026	Aa3/A+/AA
Water 2003-B	1,980,000	1/30/2003	3.02	CPI + 1.01%	48,504	7/1/2009	7/1/2009	Aa3/A+/AA
Water 2003-B	2,290,000	1/30/2003	3.31	CPI + 1.12%	37,687	7/1/2010	7/1/2010	Aa3/A+/AA
Water 2003-B	2,500,000	1/30/2003	3.55	CPI + 1.25%	36,136	7/1/2011	7/1/2011	Aa3/A+/AA
Water 2003-B	2,175,000	1/30/2003	3.74	CPI + 1.33%	16,814	7/1/2012	7/1/2012	Aa3/A+/AA
Water 2003-B	2,800,000	1/30/2003	3.87	CPI + 1.34%	22,993	7/1/2013	7/1/2013	Aa3/A+/AA
Water 2003-B	2,505,000	1/30/2003	4.00	CPI + 1.36%	20,815	7/1/2014	7/1/2014	Aa3/A+/AA
Water 2003-C	2,005,000	1/30/2003	3.87	CPI + 1.34%	15,887	7/1/2013	7/1/2013	Aa3/A+/AA
Water 2003-C	2,330,000	1/30/2003	4.00	CPI + 1.36%	(961)	7/1/2014	7/1/2014	Aa3/A+/AA
Water 2003-D	150,965,000	2/6/2003	4.00	BMA	(15,909,265)	7/1/2033	7/1/2033	Aa2/AA-/NR
Water 2004-A	77,010,000	5/13/2004	3.94	BMA	(6,144,865)	7/1/2025	7/1/2025	Aa2/AA-/NR
Water 2004-B	163,590,000	5/13/2004	3.85	BMA	(10,637,688)	7/1/2023	7/1/2023	Aa2/AA-/NR

(1). Notional amount balance as of July 1, 2005

(2). The Bond Market Association Municipal Swap Index™

(3). Denotes the swap termination date does not match the final maturity of the financings

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

Investors Service. Collateral on all swaps is to be in the form of U.S. government securities held by a third-party custodian.

Basis risk. The Fund is not exposed to significant basis risk on its swaps because most of the variable payments received are based on the Bond Market Association (BMA) index. The Consumer Price Index (CPI) indexed swaps are associated with CPI indexed financings and thus create no basis risk.

Termination risk. The Fund or counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. In such cases, the Fund may owe or be due a termination payment, depending on the value of the swap at that time. In addition, the Fund is exposed to termination risk, but not termination payments, on certain of the Fund's swaps related to Water Series 2001-C, Water Series 2003-D, Water Series 2004-A, Water Series 2004-B, Sewer Series 1998-A, Sewer Series 1998-B, Sewer Series 2001-C-1, Sewer Series 2001-C-2, and Sewer Series 2003-B. These swaps provide the counterparty with the option to terminate the swap agreement beginning on January 1, 2010, July 2, 2011, July 1, 2005, July 1, 2005, July 1, 2008, July 1, 2008, January 1, 2010, January 1, 2010, and July 1, 2013, respectively, upon the passing of certain BMA thresholds. If any of these swaps were terminated, the associated variable-rate financings would no longer carry synthetic interest rates, but there would be no termination payment.

Rollover risk. The Fund is exposed to rollover risk on swaps that mature or may be terminated prior to the maturity

of the associated financings. When these swaps terminate or, in the case of the termination option, if the counterparty exercises its option, the Fund will not realize the synthetic rate offered by the swaps on the underlying issues.

(10) Employee Benefit Plan

Substantially all City employees, including the Water Fund employees, are covered by a single-employer plan composed of a defined benefit with an optional employee-contributed annuity through the General Retirement System (GRS). The GRS pays a monthly pension to qualified individuals upon retirement. The amount is based upon a combination of years of service and annual salary.

Plan Description

The GRS is administered in accordance with the City of Detroit Charter and union contracts, which assign the authority to establish and amend contributions and benefit provisions to the Retirement System's board of trustees. The GRS issues separate, stand-alone financial statements annually. Copies of these financial statements can be obtained at the Coleman A. Young Municipal Center, 2 Woodward Ave., Rm. 908, Detroit, Michigan, 48226.

Funding Policy

The GRS funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. The contribution requirements are established and may be amended by the GRS board of trustees based on information provided by the GRS's consulting actuary. The City's contribution is set by the City Council in

(10) - Administrative Expenses

	Fiscal year ended	Annual pension cost (APC)	Percentage of APC contributed	Net pension asset
General Retirement System	June 30, 2003	\$ 12,371,235	100%	\$ —
	June 30, 2004	16,814,426	100	—
	June 30, 2005	17,571,543	956	150,452,508

(10) - B The annual pension cost and net pension asset as of June 30, 2005 is as follows:

Annual required contributions	\$ 17,571,543
Interest on net pension asset	—
Adjustment to annual required contribution	—
Annual pension cost	17,571,543
Contributions made (employer)	168,024,051
Changes in net pension asset	150,452,508
Net pension asset, beginning of year	—
Net pension asset, end of year	\$ 150,452,508

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(10) - C The actuarial methods and significant assumptions used to determine the annual required contributions for June 30, 2005 were as follows:

Valuation date	June 30, 2003
Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period	15 years
Asset valuation method	3-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.90%
Projected salary increases*	4% – 9.5%
Cost-of-living adjustments*	2.25%

*Includes inflation rate of 4%

conjunction with its approval of the City's annual budget based on information provided by the GRS's consulting actuary.

The recommended contribution rate is determined by the GRS's consulting actuary using the entry age normal actuarial cost funding method. Significant actuarial assumptions used to compute contribution requirements are the same as those used to compute the actuarial accrued liability.

Based upon the June 30, 2003 actuarial valuation, which was the most recent actuarial data available when the budget was developed for the year ended June 30, 2005, the actuary recommended a Water Fund contribution rate of 29.82%. Contributions for the Water Fund totaled \$168,024,051, which included \$152,393,380 from proceeds of the issuance of the pension obligation certificates of participation (see note 6).

Employees may elect to contribute 3%, 5%, or 7% of the first \$87,900 of annual compensation and 5% or 7% of any excess over \$87,900 for annuity savings. Contributions are voluntary for all union and nonunion employees. Contributions received from Water Fund employees during the year ended June 30, 2005 amounted to \$6,108,640.

Administrative Expenses

Actuarial investment management and bank trustee fees and expenses are included in the GRS plan's administrative expenses when incurred. In addition, the GRS plan's administrative salary, rent, accounting services, duplicating, telecommunications, and travel expenses are included in the GRS plan's administrative expenses when incurred. See charts on page 30.

(11) Due to (from) Other Funds

During the course of operations, numerous transactions occur between individual funds and other City of Detroit funds for goods provided or services rendered. Related

receivables and payables are classified as "due from other funds" or "due to other funds" on the balance sheets and are summarized. See chart on page 31.

(12) Capital Improvement Programs

The Fund is engaged in a variety of projects that are a part of its five-year Capital Improvement Program (the Program). The total cost of this program is anticipated to be approximately \$1.65 billion through fiscal year 2010. The Program is being primarily financed from revenues of the Fund and proceeds from the issuance of revenue bonds.

The total amount of construction contract commitments outstanding at June 30, 2005 and June 30, 2004 was approximately \$101 million and \$238 million, respectively.

(13) Contingencies

The Fund is also a defendant in numerous alleged claims, lawsuits, billing disputes, and other stated and pending demands. The Fund and the City's Legal Department have estimated a reserve, which is included in the accompanying financial statements, for the potential outcome of such claims or the amount of potential damages in the event of an unfavorable outcome for each of the above contingencies. The Fund's management and the City's Legal Department believe that any differences in reserved amounts and final settlement, after consideration of claims covered by insurance, resulting from such litigation will not materially impact the Fund's financial position or results of operations.

The City holds various commercial insurance policies to cover potential loss exposures.

(14) Subsequent Events

On September 22, 2005, the Water Supply System issued \$25,975,000 of SRF Junior Lien Revenue Bonds. The bonds begin to mature October 1, 2007 and will be fully matured in the year 026.

CITY OF DETROIT WATER FUND

Notes to Financial Statements June 30, 2005 and 2004

(11) Due to (from) Other Funds	2005	2004
Due from other funds (unrestricted):		
General Fund	\$ 757,819	837,888
Sewage Disposal Fund	52,391,479	29,206,443
Total due from other funds	<u>\$ 53,149,298</u>	<u>30,044,331</u>
Due from other funds (restricted):		
General Fund	\$ 33,628,639	15,909,184
Sewage Disposal Fund	6,846,660	3,118,480
Total due from other funds	<u>\$ 40,475,299</u>	<u>19,027,664</u>
Due to other funds (unrestricted):		
General Fund	\$ 17,324,357	10,748,254
Sewage Disposal Fund	48,558,282	38,420,054
Total due to other funds	<u>\$ 65,882,639</u>	<u>49,168,308</u>
Due to other funds (restricted):		
General Fund	\$ 290,175	290,175
Sewage Disposal Fund	6,225,399	7,085,526
Total due to other funds	<u>\$ 6,515,574</u>	<u>7,375,701</u>

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress (in thousands) for the General Retirement System (unaudited):

Actuarial valuation date, 30-Jun	Actuarial value of assets	Actuarial accrued liability (AAL)	Funded ratio	Unfunded AAL (UAAL)	Covered payroll	UAAL as a percentage of payroll
2001	\$ 409,336	503,589	81.28%	\$ 94,253	61,600	153.01%
2002	401,606	533,625	75.26	132,019	61,800	213.62
2003	382,785	533,860	71.70	151,075	61,000	247.66

Suburban Customers Served with Sewerage Services

By Detroit Water and Sewerage Department – FY 2004-2005

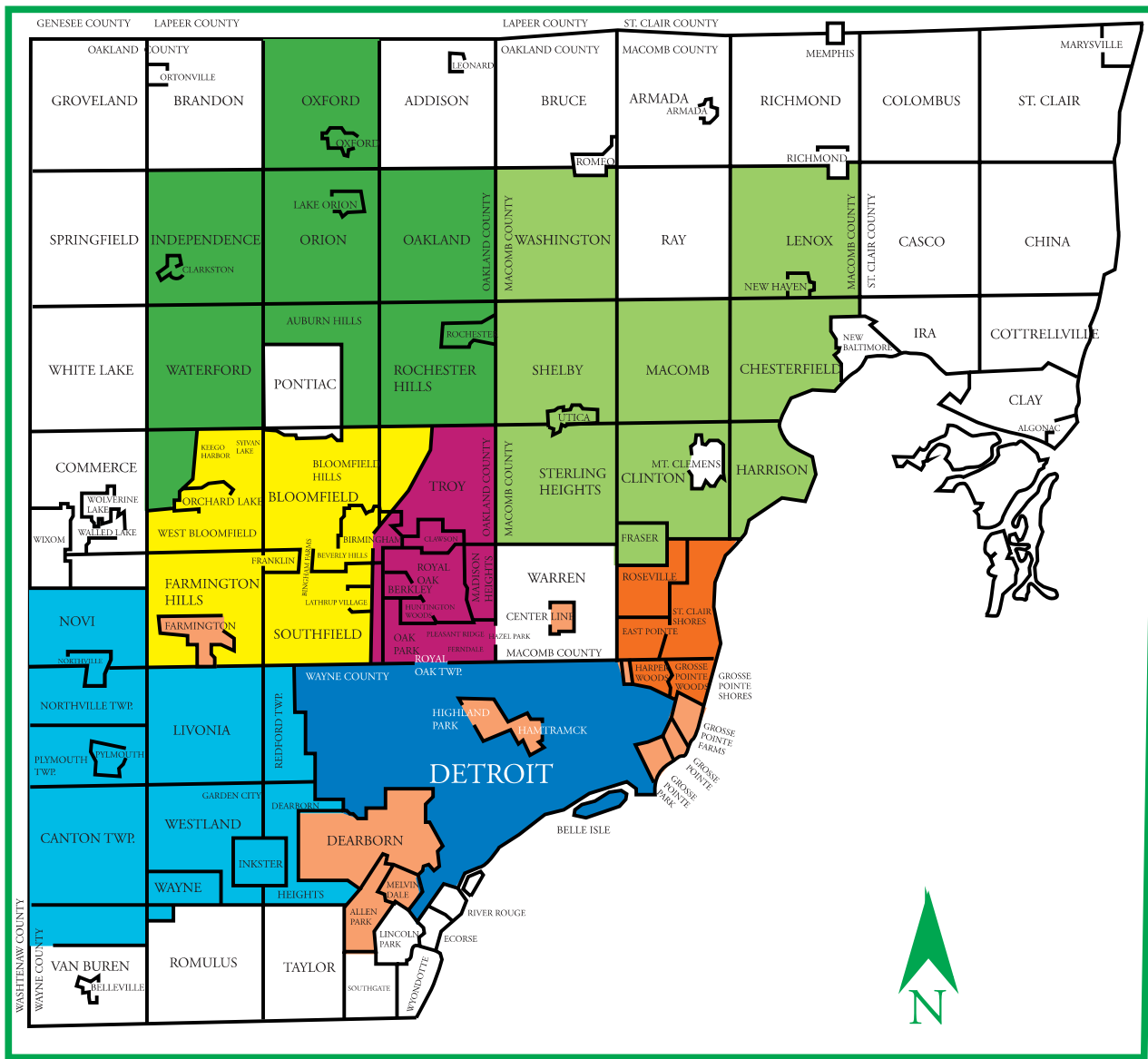
Listed By Date Service Began

Since	No.	Community	Since	No.	Community
1940	—	City of Detroit	1958	39	Bloomfield Township
1940	1	City of Grosse Pointe	1958	40	City of Bloomfield Hills
1940	2	City of Grosse Pointe Farms	1958	41	City of Farmington Hills
1940	3	City of Grosse Pointe Park	1958	42	City of Keego Harbor
1940	4	City of Grosse Pointe Woods	1958	43	City of Lathrup Village
1940	5	City of Hamtramck	1958	44	City of Auburn Hills
1940	6	City of Harper Woods	1959	45	City of Allen Park
1940	7	City of Highland Park	1959	46	Canton Township
1940	8	Redford Township	1959	47	City of Romulus
1940	9	St. Clair Shores	1959	48	Van Buren Township
1942	10	City of Southfield	1962	49	City of Inkster
1942	11	City of Berkley	1962	50	City of Wayne
1942	12	City of Clawson	1966	51	City of Sylvan Lake*
1942	13	City of Ferndale	1967	52	City of Novi
1942	14	City of Hazel Park	1969	53	Village of Bingham Farms
1942	15	City of Huntington Woods	1972	54	City of Rochester Hills
1942	16	City of Oak Park	1972	55	Chesterfield Township
1942	17	City of Pleasant Ridge	1972	56	Harrison Township
1942	18	City of Royal Oak	1972	57	Village of Lake Orion
1942	19	Royal Oak Township	1972	58	Orion Township
1942	20	City of Troy	1972	59	Oxford Township
1944	21	City of Eastpointe	1972	60	City of Sterling Heights
1944	22	City of Roseville	1972	61	Waterford Township
1950	23	City of Dearborn	1973	62	Clinton Township
1950	24	City of Dearborn Heights	1973	63	City of Fraser
1954	25	City of Birmingham	1973	64	Independence Township
1954	26	City of Center Line	1973	65	Oakland Township
1955	27	City of Garden City	1973	66	Village of Oxford
1955	28	Village of Grosse Pointe Shores	1973	67	City of Utica
1955	29	City of Livonia	1974	68	Village of Clarkston
1955	30	City of Northville	1974	69	Macomb Township
1955	31	Northville Township	1974	70	Shelby Township
1955	32	City of Plymouth	1974	71	West Bloomfield Township
1955	33	Plymouth Township	1974	72	City of Orchard Lake Village
1955	34	City of Westland	1974	73	Washington Township
1956	35	City of Farmington	1991	74	New Haven
1956	36	City of Madison Heights	1991	75	Lenox Township
1956	37	City of Melvindale	1993	76	Franklin Village
1958	38	Village of Beverly Hills	1994	77	City of Rochester

Please Note: All Townships and Villages are called out; the rest are Cities.









* Sylvan Lake is no longer served

Detroit Water and Sewerage Department Regional Wastewater Districts



2004 - 2005

Name of District

- | | | | | | |
|---|--------------|---|------------------------|---|-------------------|
|  | Detroit |  | Independent |  | S.E. Oakland Co. |
|  | Rouge Valley |  | N.E. Wayne Co. |  | Clinton - Oakland |
|  | Macomb Co. |  | Evergreen - Farmington | | |

Independent Auditors' Report

The Board of Water Commissioners,
the Honorable Mayor, and
Members of the City Council
City of Detroit, Michigan:

We have audited the accompanying basic financial statements of the Sewage Disposal Fund (the Fund), an Enterprise fund of the City of Detroit, Michigan (the City), as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting of the Fund. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements referred to above present only the Sewage Disposal Fund of the City of Detroit, Michigan and are not intended to present fairly the financial position of the City of Detroit, Michigan as of June 30, 2005 and 2004, and the changes in its financial position, and, where applicable, cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Sewage Disposal Fund of the City of Detroit, Michigan as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 31, 2006 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Fund has not presented Management's Discussion and Analysis, which U.S. generally accepted accounting principles have determined is necessary to supplement, although not required to be part of, the basic financial statements.

The schedule of funding progress on page 25 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

March 31, 2006



KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

CITY OF DETROIT SEWAGE DISPOSAL FUND

Statements of Net Assets, June 30, 2005 and 2004

Assets	2005	2004
Current assets:		
Investments	\$ 47,948,538	40,242,687
Due from other funds	66,388,078	40,413,894
Accounts receivable (including \$41,695,332 and \$45,030,242 for unbilled sewage services and net of allowance for doubtful accounts of \$64,482,340 and \$42,901,655 for June 30, 2005 and 2004, respectively)	88,501,230	112,592,864
Rate adjustments receivable from customers	12,174,737	21,842,391
Prepaid expenses	381,847	5,880
Inventories	11,173,380	10,890,503
Restricted cash	12,289,108	31,905,215
Restricted investments	275,424,204	349,717,460
Restricted due from other funds	37,638,549	20,688,810
Total current assets	551,919,671	628,299,704
Noncurrent assets:		
Restricted long-term investments	308,770,507	261,766,757
Net pension asset	7,850,281	—
Noncurrent rate adjustments receivable from customers	44,946,430	13,430,669
Issuance costs – pension obligation certificates of participation	286,646	—
Unamortized bond issuance costs	35,433,200	31,105,792
Capital assets:		
Land	13,876,751	13,876,751
Structures	1,143,914,922	891,488,855
Interceptors, regulators, and improvements	542,769,689	532,455,750
Equipment	708,031,859	572,095,371
Construction work in progress	1,219,986,063	1,203,738,078
Total capital assets	3,628,579,284	3,213,654,805
Less accumulated depreciation	(681,127,715)	(637,571,035)
Net capital assets	2,947,451,569	2,576,083,770
Total noncurrent assets	3,344,738,633	2,882,386,988
Total assets	\$ 3,896,658,304	3,510,686,692

CITY OF DETROIT SEWAGE DISPOSAL FUND

Statements of Net Assets, June 30, 2005 and 2004

Liabilities and Net Assets	2005	2004
Current liabilities:		
Current liabilities payable from current assets:		
Book cash overdraft	\$ 758,762	134,189
Accounts and contracts payable	7,683,870	13,928,353
Due to other funds	53,133,721	34,675,106
Accrued salaries and wages	1,629,152	1,455,830
Rate adjustments payable to customers	4,938,657	4,048,127
Accrued workers' compensation	895,155	1,181,346
Accrued compensated absences	5,556,011	6,051,544
Other current accrued liabilities	754,691	360,864
Total current liabilities payable from current assets	75,350,019	61,835,359
Current liabilities payable from restricted assets:		
Revenue bonds and revolving loan payable within one year	50,035,000	44,825,000
Accrued bond interest payable	38,654,433	25,691,034
Other liabilities	89,017	—
Accounts and contracts payable	62,465,874	78,922,676
Due to other funds	11,074,002	5,207,146
Total current liabilities payable from restricted assets	162,318,326	154,645,856
Total current liabilities	237,668,345	216,481,215
Long-term liabilities:		
Revenue bonds and revolving loan payable	2,609,004,255	2,321,850,625
Pension obligation certificates of participation payable	8,760,811	—
Deferred swap termination fees	2,286,256	14,056,137
Rate adjustments payable to customers	7,054,465	5,329,657
Accrued workers' compensation	3,832,814	4,025,338
Accrued compensated absences	8,361,795	6,106,719
Total long-term liabilities	2,639,300,396	2,351,368,476
Total liabilities	2,876,968,741	2,567,849,691
Net assets:		
Invested in capital assets, net of related debt	646,808,681	610,829,187
Restricted for capital acquisitions and bond payments	166,369,102	130,303,233
Unrestricted	206,511,780	201,704,581
Total net assets	\$ 1,019,689,563	942,837,001

See accompanying notes to basic financial statements.

CITY OF DETROIT SEWAGE DISPOSAL FUND

Statements of Revenues, Expenses, and Changes in Fund Net Assets, June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
General customers	\$ 146,456,155	135,752,132
Suburban customers	158,120,913	170,810,298
City departments	281,062	998,336
Sewage surcharge	5,914,639	3,155,337
Miscellaneous	<u>2,815,506</u>	<u>3,856,227</u>
Total operating revenues, net	<u>313,588,275</u>	<u>314,572,330</u>
Operating expenses before depreciation:		
Sewage treatment plant	103,536,940	108,834,440
Interceptors and regulators	740,870	182,574
Sewer pumping stations	3,122,298	5,076,606
Sewer maintenance and engineering	12,348,658	15,566,222
Combined sewage overflow control basins	511,252	1,141,192
Commercial	5,698,629	6,321,194
Administrative and general	<u>37,441,707</u>	<u>40,624,344</u>
Total operating expenses before depreciation	<u>163,400,354</u>	<u>177,746,572</u>
Operating income before depreciation	150,187,921	136,825,758
Depreciation	<u>44,053,316</u>	<u>50,085,670</u>
Total operating income	<u>106,134,605</u>	<u>86,740,088</u>
Nonoperating revenues (expenses):		
Earnings on investments	14,930,952	8,017,586
Interest expense, net of capitalized interest	(44,205,957)	(59,629,554)
Miscellaneous	<u>(7,038)</u>	<u>(4,699,023)</u>
Total nonoperating expense	<u>(29,282,043)</u>	<u>(56,310,991)</u>
Increase in net assets	<u>76,852,562</u>	<u>30,429,097</u>
Net assets – beginning of year	<u>942,837,001</u>	<u>912,407,904</u>
Net assets – end of year	<u>\$ 1,019,689,563</u>	<u>942,837,001</u>

See accompanying notes to basic financial statements.

CITY OF DETROIT SEWAGE DISPOSAL FUND

Statements of Cash Flows, June 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Receipts from customers	\$ 326,617,651	323,241,563
Internal activity – payments to other funds	(18,598,461)	(3,467,351)
Payments to suppliers	(124,774,098)	(109,592,661)
Payments to the General Retirement System in excess of annual required contributions	(7,850,281)	—
Payments to employees	(68,354,090)	(43,049,784)
Net cash provided by operating activities	107,040,721	167,131,767
Cash flows from noncapital and related financing activities:		
Proceeds from issuance of pension obligation certificates of participation	8,760,811	—
Issuance costs – pension obligation certificates of participation	(286,646)	—
Bank overdraft	758,762	134,189
Net cash provided by noncapital and related activities	9,232,927	134,189
Cash flows from capital and related activities:		
Acquisition and construction of capital assets, net	(364,680,084)	(354,410,519)
Principal paid on revenue bond maturities and revolving loan	(32,590,000)	(38,745,000)
Interest paid on revenue bonds	(82,010,501)	(113,346,957)
Principal paid on refunded debt	(108,765,000)	(103,845,000)
Proceeds from bond issuance and increase in revolving note payable, net	426,848,891	208,532,328
Swap termination fee	(11,750,000)	14,056,137
Other receipts	—	410,035
Unamortized discount and bond issuance cost	2,542,333	2,644,404
Net cash used in capital and related financing activities	(170,404,361)	(384,704,572)
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	651,726,904	847,618,237
Purchase of investments	(632,143,250)	(651,726,904)
Interest received on investments	14,930,952	8,017,587
Net cash provided by investing activities	34,514,606	203,908,920
Net decrease in cash	(19,616,107)	(13,529,696)
Cash at beginning of year	31,905,215	45,434,911
Cash at end of year	\$ 12,289,108	31,905,215
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 106,134,605	86,740,088
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	44,053,316	50,085,670
Provision for uncollectible accounts	21,580,685	5,237,411
Changes in certain assets and liabilities:		
(Increase) decrease in accounts receivable	2,510,949	(10,074,723)
Increase in rate refund receivable from customers	(21,982,296)	(6,468,196)
(Increase) decrease in prepaid expenses	(375,967)	29,477,360
(Increase) decrease in inventories	(282,877)	3,365,569
Increase in net pension asset	(7,850,281)	—
Increase (decrease) in accounts and contracts payable	(22,701,285)	5,412,445
Increase in accrued salaries and wages	173,323	257,530
Increase in rate refund payable to customers	2,615,338	4,041,931
Increase in other accrued liabilities and accrued compensated absences and accrued workers' compensation	1,763,672	2,524,033
Net change in due (to) from other funds	(18,598,461)	(3,467,351)
Net cash provided by operating activities	\$ 107,040,721	167,131,767

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

(1) Summary of Significant Accounting Policies

The City of Detroit (the City) Charter established the Water and Sewerage Department (the Department) in the year 1836 to supply water, drainage, and sewage service within and outside the City under the administration of the Board of Water Commissioners. The Sewage Disposal Fund (the Fund), an Enterprise fund, separately accounts for the Sewage Disposal System (the System), as is required by bond ordinances of the City. The following is a summary of the more significant accounting policies followed in the preparation of the Fund's financial statements. These policies conform to U.S. generally accepted accounting principles.

The financial statements of the Fund have been included in the City of Detroit's Comprehensive Annual Financial Report and reported as an Enterprise fund. Copies of these reports, along with other financial information, can be obtained at the Fund's administrative office, located at 735 Randolph, Detroit, Michigan, 48226.

(a) Basis of Accounting

The accounting policies of the Fund conform to U.S. generally accepted accounting principles (GAAP) as applicable to governmental entities. The accounts of the Fund, which are organized as an Enterprise fund, are used to account for the Fund's activities, which are financed and operated in a manner similar to a private business enterprise. Accordingly, the Fund maintains its records on the accrual basis of accounting. Revenues from operations, investments, and other sources are recorded when earned. Expenses (including depreciation and amortization) of providing services to the public are accrued when incurred.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Fund applies all applicable GASB pronouncements, as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Fund also has the option of following FASB guidance issued after November 30, 1989, but has elected not to do so.

(b) Cash and Cash Equivalents

Cash and cash equivalents consist of "cash" as on deposit in financial institutions, including restricted assets.

(c) Investments

Investments are stated at fair value based on quoted market price.

(d) Inventories

Inventories consist of operating and maintenance and repair parts for sewage lines and are valued at the lower of cost or market, with cost being determined on a first-in, first-out (FIFO) basis.

(e) Capital Assets

Capital assets are recorded at historical cost, together with interest capitalized during construction. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets as follows:

Improvements to land	67 years
Structures	40 years
Interceptors and regulators	100 years
Equipment	3 – 20 years

(f) Workers' Compensation

The Fund has no insurance coverage for workers' compensation claims. Workers' compensation expenses are recorded when the occurrence of the liability is probable and the amount is reasonably estimable. The amounts recorded as of June 30, 2005 and 2004 are based on compensation expected to be paid, along with estimated medical costs, for all claims known as of the balance sheet date, and historical data are used in computing the liability for estimated incurred but unknown claims as of the balance sheet date. See chart below.

(g) Capitalized Interest

The Fund capitalizes qualifying net interest costs of the System on bonds issued for capital construction in accordance with Statement of Financial Accounting Standards Nos. 34 and 62. Accordingly, capitalized interest for the years ended June 30, 2005 and 2004 was \$50,767,951 and \$50,451,250, respectively.

(f) - Workers' Compensation

		June 30		
		2005	2004	2003
Balance at beginning of year	\$	5,206,684	4,844,529	6,970,321
Current year claims and changes in estimates		475,827	1,543,501	(964,891)
Claims payments		(954,542)	(1,181,346)	(1,160,901)
Balance at end of year	\$	4,727,969	5,206,684	4,844,529

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

(h) Taxes and City Services

The Fund pays no direct federal, state, or local taxes, except local taxes on excess property and federal Social Security taxes. The Fund reimburses the City for most of the direct services furnished by other City departments, including general staff services. Charges are billed for all sewage services provided to City departments.

(i) Shared Costs

Costs related to shared facilities and personnel are allocated to the Fund on a basis that relates costs incurred to the fund benefited.

(j) Compensated Absences

The Fund records as a liability estimated vested vacation, sick pay, and banked overtime in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Unused vacation pay accumulates until termination of employment, while there is no vesting of sick pay until an employee reaches age 60 or completes 25 years of service.

(k) Accrued Revenue

The Fund records unbilled revenues for services provided prior to year-end by accruing actual revenues billed in the subsequent month.

(l) Net Assets

Net assets are categorized as follows:

Invested in capital assets: This consists of capital assets, net of accumulated depreciation and related debt.

Restricted: This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the City's policy to use restricted resources first, and then unrestricted resources when they are needed.

Unrestricted: This consists of net assets that do not meet the definition of "restricted" or "invested in capital assets."

(m) Classification of Revenues

The Fund has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues: Operating revenues include activities that have the characteristics of exchange transactions, such as revenue from charges for sewage service.

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, which are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities That Use Proprietary Fund Accounting*,

and GASB Statement No. 34, such as investment income and interest expense.

(n) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(o) New Accounting Pronouncements

The Fund adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an Amendment of GASB Statement No. 3*, for the year ended June 30, 2005. This pronouncement requires additional disclosures presented in these notes, but has no impact on net assets of the Fund. These disclosures address common deposits and investment risks related to credit risk, concentration of credit risk, interest risk, and foreign currency risk. GASB 40 does not address the retroactive applicability of required disclosures, and, except for custodial credit risk, the Fund did not disclose deposit and investment risks at June 30, 2004.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets. The City will implement Statement No. 42 beginning with the year ended June 30, 2006. The City is currently evaluating the impact of adopting Statement No. 42.

In July 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes accounting and financial reporting standards for employers that participate in a defined-benefit "other postemployment benefit" (OPEB) plan. The City will implement Statement No. 45 beginning with the year ended June 30, 2006. The City is currently evaluating the impact of adopting Statement No. 45.

(2) Deposits and Investments

The following is a complete listing of deposits and investments held by the City at June 30, 2005:

Deposits	\$ 24,056,661
Investments	620,375,696
Total deposits and investments	<u>\$ 644,432,357</u>

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

The deposits and investments of the City at June 30, 2005 are reflected in the financial statements as follows:

Unrestricted:		
Investments	\$	47,948,538
Restricted:		
Cash		12,289,108
Investments – current		275,424,204
Investments – noncurrent		308,770,507
Total cash and investments	\$	<u>644,432,357</u>

State law authorizes the City to make deposits in the accounts of federally insured financial institutions. Cash held by fiscal agents or by trustees is secured in accordance with the requirements of the agency or trust agreement.

The City is authorized to invest in obligations of the U.S. government or its agencies, certificates of deposit, savings and depository accounts of insured institutions, commercial paper of certain investment quality, repurchase agreements, banker's acceptances, mutual funds of certain investment quality, and investment pools as authorized by state law.

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of bank failure, the Fund's deposits may not be returned by

the bank. The City does not have a deposit policy for custodial credit risk. At June 30, 2005 and 2004, the Fund had deposits of \$12,918,713 and \$31,912,638, respectively, that were exposed to custodial credit risk, as they were uninsured and uncollateralized.

Custodial Credit Risk of Investments

Custodial credit risk is the risk that in the event of failure of the counterparty, the Fund will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City does not have a policy for custodial credit risk. As of June 30, 2005 and 2004, the Fund had no investments subject to custodial credit risk.

Interest Rate Risk

Interest rate risk is the risk that, over time, the value of investments will decrease as a result of a rise in interest rates. The City's investment policy does not specifically restrict investment maturities other than commercial paper, which can only be purchased with a 270-day maturity. The City's policy minimizes interest rate risk by requiring that the Fund attempt to match its investments with anticipated cash flow requirements. Unless related to a specific cash flow, the City is generally not permitted to directly invest in securities maturing more than 10 years from the original date of purchase. See the charts below.

(2) - Interest Rate Risk		Investment maturities in years			
Investment	Fair value	Less than one year	One to five years	Six to ten years	Over ten years
U.S. government agency securities	\$ 314,319,617	111,627,418	199,784,590	2,907,609	—
U.S. Treasury	12,976,157	12,976,157	—	—	—
Repurchase agreements	65,740,154	14,816,154	14,924,000	—	36,000,000
Money market	227,339,768	227,339,768	—	—	—
Total investments	\$ <u>620,375,696</u>	<u>366,759,497</u>	<u>214,708,590</u>	<u>2,907,609</u>	<u>36,000,000</u>

Credit Risk

The City of Detroit's investment policy complies with state law. The City limits its investments in commercial paper, mutual funds, and external investment pools that purchase

commercial paper to the top two rating classifications issued by two nationally recognized statistical rating organizations (NRSROs).

As of June 30, 2005, the Fund had the following investments, maturities, and credit quality ratings of debt securities:

(2) - Credit Risk				
Investment	Fair value	Rating	Rating organization	
U.S. government agency securities	\$ 291,210,367	AAA	S&P	
U.S. government agency securities	23,109,250	Aaa	Moody's	
U.S. Treasury	12,976,157	AAA	S&P	
Repurchase agreements	5,000,000	AAA	S&P	
Repurchase agreements	36,000,000	AA-	S&P	
Repurchase agreements	9,816,154	A+	S&P	
Repurchase agreements	14,924,000	A-	S&P	
Money market	10,645,531	AAA	S&P	
Money market	4,882,509	Aaa	Moody's	
Money market	211,811,728	Not rated	N/A	
Total investments	\$ <u>620,375,696</u>			

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the Fund's investment in a single issuer. The City's policy specifies a number of limitations to minimize concentration of credit risk, including prohibiting investing more than 5% of the portfolio in securities (other than U.S. government, mutual funds, external investment pools, and other pooled investments) of any one issuer.

More than 5% of the Fund's investments are in Federal Home Loan Bank and Federal National Mortgage Association securities. These investments are 31% and 15.9%, respectively, of the Fund's total investments.

(3) Restricted Assets

Restricted assets, principally cash and investments, are available for debt service on revenue bonds and to provide funds for improvements, enlargements, extensions, and construction. In certain instances, minimum levels of assets are required by bond ordinance provisions or by Board of Water Commissioners decree. These assets are maintained as follows: (1) With respect to the Bond and Interest Redemption Fund, after provision has been made for expenses of operation and maintenance of the System, a sum proportionately sufficient to provide for payment, when due, of the current principal and interest is set aside. The Bond Reserve Account is part of the Bond and Interest Redemption Fund, and the amounts credited to this account are to be used only to pay principal and interest on the bonds when current revenues are not sufficient. (2) With respect to the Extraordinary Repair and Replacement Reserve Fund, after meeting the requirements of the

foregoing funds, monthly deposits in an amount equal to one twelfth of 3% of the budgeted operation and maintenance expense of the System for the fiscal year must be set aside until the aggregate amount funded totals at least 15% of that year's budgeted operating and maintenance costs. These deposits are to be used for major unanticipated repairs and replacement to the System with actual or anticipated cost exceeding \$1 million. Once this fund is fully funded, deposits required are amounts needed to maintain fully funded status. Borrowings of up to 50% of the balance in this fund on the first day of the related fiscal year are allowed for transfer to and use from the Improvement and Extension Fund. Any such borrowings must be repaid prior to any deposits being made to the Improvement and Extension Fund. (3) After the aforementioned deposits have been made, excess amounts may be deposited in the Improvement and Extension Fund, established for the payment of improvements, enlargements, repairs, extensions, or betterment to the System. (4) With respect to the Construction Fund, the portion of the proceeds of the sale of bonds for building or improving the System is deposited in this fund. A separate depository account is required for each series of bonds. Proceeds for construction purposes received from federal and state grants and other sources that restrict the use of such proceeds are also deposited into this account.

When both restricted and unrestricted resources are available for use, generally it is the City's policy to use restricted resources first, and then unrestricted resources when they are needed.

(4) - Capital Assets

Capital asset activity for the fiscal years ended June 30, 2005 and 2004 is as follows:

	Balance, June 30, 2004	Additions	Dis pos als	Balance, June 30, 2005
Nondepreciable assets:				
Land	\$ 13,876,751	—	—	13,876,751
Construction in progress	1,203,738,078	439,665,001	(423,417,016)	1,219,986,063
	<u>1,217,614,829</u>	<u>439,665,001</u>	<u>(423,417,016)</u>	<u>1,233,862,814</u>
Depreciable assets:				
Interceptors, regulators, and land improvements	532,455,750	10,313,939	—	542,769,689
Structures	891,488,855	252,665,492	(239,425)	1,143,914,922
Equipment	572,095,371	136,220,745	(284,257)	708,031,859
Accumulated depreciation	<u>(637,571,035)</u>	<u>(44,053,316)</u>	<u>496,636</u>	<u>(681,127,715)</u>
	<u>1,358,468,941</u>	<u>355,146,860</u>	<u>(27,046)</u>	<u>1,713,588,755</u>
Total	\$ <u>2,576,083,770</u>	<u>794,811,861</u>	<u>(423,444,062)</u>	<u>2,947,451,569</u>

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

(4) - Capital Assets

Capital asset activity for the fiscal years ended June 30, 2004 and 2003 is as follows:

	Balance, June 30, 2003	Additions	Disposals	Balance, June 30, 2004
Nondepreciable assets:				
Land	\$ 13,825,671	51,080	—	13,876,751
Construction in progress	887,576,854	399,832,718	(83,671,494)	1,203,738,078
	<u>901,402,525</u>	<u>399,883,798</u>	<u>(83,671,494)</u>	<u>1,217,614,829</u>
Depreciable assets:				
Interceptors, regulators, and land improvements	536,209,238	(3,753,488)	—	532,455,750
Structures	805,223,844	86,265,011	—	891,488,855
Equipment	573,013,498	1,040,769	(1,958,896)	572,095,371
Accumulated depreciation	<u>(589,431,742)</u>	<u>(50,085,670)</u>	<u>1,946,377</u>	<u>(637,571,035)</u>
	<u>1,325,014,838</u>	<u>33,466,622</u>	<u>(12,519)</u>	<u>1,358,468,941</u>
Total	\$ <u>2,226,417,363</u>	<u>433,350,420</u>	<u>(83,684,013)</u>	<u>2,576,083,770</u>

(5) Revenue Bonds

The outstanding indebtedness of the Fund was \$2,653,826,572 and \$2,375,152,599 at June 30, 2005 and 2004, respectively. The interest rates on the outstanding bonds range from 4.2% to 6.5%. Net revenues of the Fund are pledged to repayment of bonds.

Future debt service requirements at June 30, 2005 See chart below.

In fiscal 2005, the Fund issued \$273,355,000 of City of Detroit, Michigan, Sewage Disposal System Revenue Second Lien Bonds, Series 2005-A; \$40,215,000 of City of Detroit, Michigan Sewage Disposal System Revenue Refunding Second Lien Bonds, Series 2005-B; and \$63,160,000 of City of Detroit, Michigan Sewage Disposal System Revenue Refunding Second Lien Bonds, Series

2005-C. The net proceeds were used to refund a portion of the City's outstanding Sewage Disposal System Revenue Bonds and Revenue Refunding Bonds and to pay costs of issuance associated with the 2005 bonds.

The net proceeds of the Sewage Disposal System Revenue Second Lien Bonds, Series 2005-A, will be used (a) to deposit into the Construction Fund and (b) for the payment of the related costs of issuance, including the premium for the municipal bond insurance.

The net proceeds of the Sewage Disposal System Revenue Refunding Second Lien Bonds, Series 2005-B, will be used (a) to advance-refund the \$22,355,000 principal amount of the City's Sewage Disposal System Senior Lien Bonds, Series 1997-A, comprising serial bonds maturing in the year 2022 (the Advance Refunded 1997-A Bonds), with an average interest rate of 5%, (b) to advance-

(5) - Revenue Bonds

	Principal	Bond interest	Swap interest	Total requirements
Year ending June 30:				
2006	\$ 50,035,000	72,111,998	11,712,696	133,859,694
2007	53,205,000	80,949,567	11,696,537	145,851,104
2008	51,180,000	79,415,397	11,671,694	142,267,091
2009	59,449,128	76,833,885	11,646,096	147,929,109
2010	59,685,152	74,674,458	11,619,708	145,979,318
2011 – 2015	312,548,398	352,132,626	57,399,546	722,080,570
2016 – 2020	352,125,636	307,012,811	53,521,204	712,659,651
2021 – 2025	391,963,258	226,616,137	44,326,094	662,905,489
2026 – 2030	568,030,000	145,170,693	26,379,535	739,580,228
2031 – 2035	660,365,000	74,195,478	10,473,104	745,033,582
2036 – 2040	<u>95,240,000</u>	<u>4,642,000</u>	<u>—</u>	<u>99,882,000</u>
	\$ <u>2,653,826,572</u>	<u>1,493,755,050</u>	<u>250,446,214</u>	<u>4,398,027,836</u>

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

refund \$115,000 of 1999-A Sewage Disposal System Senior Lien Bonds, maturing in 2011, and \$3,425,000 1999-B Sewage Disposal System Senior Lien Bonds, maturing in 2012 (the Advance Refunded 1999-A Bonds), with an average interest rate of 5.20% and 5.25%, respectively, (c) to advance-refund \$8,215,000 of 2003-A Sewage Disposal System Senior Lien Bonds, maturing in 2014, and \$8,470,000 Sewage Disposal System Senior Lien Bonds, maturing in 2015 (the Advance Refunded 2003-A Bonds), with an average interest rate of 5.0%, and (d) the payment of the related costs of issuance, including the premium for the municipal bond insurance.

The proceeds of the Sewage Disposal System Revenue Refunding Second Lien Bonds, Series 2005-C, will be used (a) to currently refund \$6,770,000 principal amount of the City's Sewage Disposal System Senior Lien Bonds, Series 1995-A bonds, maturing in the year 2025, with an average interest rate of 5%, (b) to currently refund the following amounts of the City's Sewage Disposal System Senior Lien Bonds, Series 1995-B bonds, \$2,400,000 principal amount maturing in the year 2008, with an average interest rate of 5.25%, \$20,410,000 principal amount of term bonds maturing in the year 2015, with an average interest rate of 5.25%, and \$36,605,000 principal amount of term bonds, maturing in the year 2021, with an average interest rate of 5.25% (together with (a) the "Currently Refunded 1995-A/B Bonds"), and (c) for the payment of the related costs of issuance, including the premium for the municipal bond insurance.

Proceeds of the Refunding Bonds were deposited into an irrevocable trust with an escrow agent to provide for all future principal and interest payments on the Currently Refunded 1995-A/B Bonds when due to and including July 1, 2005 at 100% and 101%; the Advance Refunded 1997-A Bonds when due to and including July 1, 2007 at 101%; the Advance Refunded 1999-A Bonds when due to and including July 1, 2010 at 101%; and the Advance Refunded 2003-A Bonds when due to and including July 1, 2013 at 100%.

The advance refunding resulted in a difference between the reacquisition price and net carrying amount of the old debt of \$8,987,394. This difference, reported in the financial statements as a deduction from bonds payable, is being charged to operations through the year 2024 using the straight-line method. The fund completed the advance refunding to reduce its total debt service payments over the next 20 years and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$6,143,299.

In prior years, the Fund defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old

bonds. Accordingly, the trust account assets and liabilities for the defeased bonds are not included in the Fund's financial statements. Similarly, the interest expense related to the defeased bonds and the related interest income earned on the escrow fund investments have not been recognized in the statements of revenues, expenses, and changes in fund net assets. As of June 30, 2005 and 2004, approximately \$593,330,000 and \$490,565,000, respectively, of bonds outstanding are considered defeased.

Bonds outstanding at June 30, 2005 include \$2,318,471,573 of bonds callable at various dates after June 30, 2005. These bonds are callable at varying premiums, depending on the issue and length of time to maturity.

(6) Issuance of Pension Obligation Certificates

On June 2, 2005, the Detroit Retirement Systems Funding Trust issued \$1.44 billion (\$640 million of taxable fixed-rate Series A and \$800 million of taxable floating-rate Series B) of taxable pension obligation certificates of participation (POCs). The Trust was created by the Detroit General Retirement System Service Corporation (DGRSSC) and the Detroit Police and Fire Retirement System Service Corporation (DPFRSSC), both blended component units of the City. The City entered into service contracts with the DGRSSC and the DPFRSSC to facilitate the transaction. The POCs represent undivided proportionate interests in the rights to receive the payments from the City under its service contracts with the DGRSSC and the DPFRSSC.

The POCs were issued for the purpose of funding certain unfunded accrued actuarial liabilities (UAAL) of the two retirement systems of the City, which include the General Retirement System (GRS) and the Police & Fire Retirement System (PFRS). The UAAL is a liability of the City for past services rendered by its employees in which Michigan state law and the Michigan Constitution require that a portion be annually paid. The GRS includes employees and retirees of certain Enterprise funds, including the Sewage Disposal Fund.

A total \$8,760,811 of the \$1,440,000,000 in POCs issued is attributable and allocated to the Sewerage Fund. The amount of \$286,646 relates to issuance costs that are recorded as an asset and will be amortized over 20 years, the life of the POCs; \$8,474,165 of the proceeds were contributed to the GRS, which included \$623,884 of annual required contributions for June 30, 2005. The remaining amount of \$7,850,281 resulted in a net pension asset.

Interest payments for Series A will commence on December 15, 2005 and are due semiannually, while the first principal payment is payable June 15, 2007, due annually, and is payable through 2025. Interest payments for Series B will

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

(6) - The redemption dates and aggregate principal and interest amounts for each such redemption date.

	Principal amounts	Interest	Total
Year ending June 30:			
2006	\$ —	303,729	303,729
2007	179,948	430,462	610,410
2008	220,296	422,539	642,835
2009	265,486	412,735	678,221
2010	313,686	400,851	714,537
2011 – 2015	2,438,918	1,739,685	4,178,603
2016 – 2020	3,026,492	1,009,247	4,035,739
2021 – 2025	2,315,985	395,075	2,711,060
Total	\$ 8,760,811	5,114,323	13,875,134

commence on September 15, 2005 and are due quarterly through 2025, while the first principal payment is payable June 15, 2007, due annually, and is payable through 2025. The interest rates on the outstanding obligations range from 4.004% and 4.948%.

The redemption dates and aggregate principal and interest amounts for each such redemption date. See chart above.

(7) Deferred Swap Termination Proceeds and Payments

During the year ended June 30, 2005, the Fund and its counterparty terminated a forward starting swap agreement related to the issuance of debt in fiscal year 2005. The Fund paid a termination payment in the amount of \$11.75 million that has been reserved to offset future debt service. The expense will be recognized over the life of the debt that was issued in fiscal year 2005 using the straight-line method.

During the year ended June 30, 2004, the Fund and its counterparty terminated a forward starting swap agreement related to the future issuance of debt in fiscal year 2005. The Fund received a termination payment in the amount of \$14,056,137 that has been deferred to offset future debt service. The proceeds will be recognized over the life of the debt using the straight-line method.

(8) Long-Term Liabilities

Long-Term Liabilities Long-term liability activity for the years ended June 30, 2005 and 2004. See charts on page 46.

(9) Derivatives Not Reported at Fair Value

The Fund is party to derivative financial instruments consisting of interest rate swaps that are intended to effectively convert variable-rate financings to fixed-rate financings. These are not reported at fair value on the statement of net assets at June 30, 2005.

Objective of the swaps. In order to better manage its interest rate exposure and to reduce the overall costs of its financings, the Fund has entered into six separate fixed-payer interest rate swaps.

Market access risk. The City is exposed to market access risk on its hedge swaps or forward starting swaps in the event that it will not be able to enter credit markets or in the event that credit will become more costly.

Terms, fair values, and credit risk. Certain key terms, fair market values, and counterparty credit ratings relating to the outstanding swaps as of June 30, 2005 are presented below. The notional amounts of the swaps, except those with effective dates of September 1, 2006 and March 1, 2007, match the principal amounts of the outstanding financings. The swaps with effective dates of September 1, 2006 and March 1, 2006 were entered into to hedge future interest rate risk and will be associated with financings expected to be issued prior to the effective dates. Except as discussed under rollover risk, the Fund's swap agreements contain scheduled reductions to outstanding notional amounts that match scheduled or anticipated amortization of associated financings. See chart on page 47.

Fair value. Because interest rates have generally declined since the time the swaps were negotiated, most of the Fund's swaps have a negative fair value as of June 30, 2005. The negative fair values may be countered by lower total interest payments required under the variable-rate financings, creating lower synthetic interest rates.

Credit risk. As of June 30, 2005, the Fund was not significantly exposed to net credit risk, as the majority of the swaps had net negative fair values. However, should interest rates change and fair values of the swaps become

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

(8) - Long-Term Liabilities Long-term liability activity for the years ended June 30, 2005 and 2004

	Balance, June 30, 2004	Increase	Decrease	Balance, June 30, 2005	Amount due within one year
Revenue bonds payable	\$ 2,375,152,600	420,028,972	(141,355,000)	2,653,826,572	50,035,000
Add:					
Unamortized premium	70,051,130	17,150,459	(3,524,633)	83,676,956	—
Less:					
Deferred charges on refunding	62,230,146	4,456,953	(3,592,443)	63,094,656	—
Discount	16,297,959	—	(928,342)	15,369,617	—
Net revenue bonds	2,366,675,625	432,722,478	(140,358,848)	2,659,039,255	50,035,000
Pension obligation certificates payable	—	8,760,811	—	8,760,811	—
Other liabilities:					
Accrued workers' compensation	5,206,684	475,827	(954,542)	4,727,969	895,155
Accrued compensated absences	12,158,263	2,255,075	(495,532)	13,917,806	5,556,011
Deferred swap termination	14,056,137	—	(11,769,881)	2,286,256	—
Total other liabilities	31,421,084	2,730,902	(13,219,955)	20,932,031	6,451,166
Total	\$ 2,398,096,709	444,214,191	(153,578,803)	2,688,732,097	56,486,166

	Balance, June 30, 2003	Increase	Decrease	Balance, June 30, 2004	Amount due within one year
Revenue bonds payable	\$ 2,311,620,907	206,121,693	(142,590,000)	2,375,152,600	44,825,000
Add:					
Unamortized premium	60,163,537	12,830,333	(2,942,740)	70,051,130	—
Less:					
Deferred charges on refunding	56,434,401	9,011,821	(3,216,076)	62,230,146	—
Discount	17,226,300	—	(928,341)	16,297,959	—
Net revenue bonds	2,298,123,743	209,940,205	(141,388,323)	2,366,675,625	44,825,000
Other liabilities:					
Accrued workers' compensation	4,844,529	1,543,501	(1,181,346)	5,206,684	1,181,346
Accrued compensated absences	9,965,977	2,345,824	(153,538)	12,158,263	6,051,544
Deferred swap termination	—	14,056,137	—	14,056,137	—
Total other liabilities	14,810,506	17,945,462	(1,334,884)	31,421,084	7,232,890
Total	\$ 2,312,934,249	227,885,667	(142,723,207)	2,398,096,709	52,057,890

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

(9) - Terms, fair values, and credit risk

Associated financing issue	Notional amounts (1)	Effective date	Fixed rate paid	Variable rate received	Fair values	Sweep termination date	Final maturity of bonds	Counterparty credit rating
Sewage 1998-A	\$ 68,000,000	12/10/1998	4.51%	BMA (2)	\$ (8,544,876)	7/1/2023	7/1/2023	Aa2/AA-/NR
Sewage 1998-B	67,900,000	12/10/1998	4.51	BMA	(8,570,700)	7/1/2023	7/1/2023	Aa2/AA-/NR
Sewage 2001 C-1	156,500,000	10/23/2001	4.43	BMA	15,585,954	7/1/2027	7/1/2027	Aa2/AA+/AAA
Sewage 2001 C-2	124,500,000	10/23/2001	4.47	BMA	13,784,417	7/1/2029	7/1/2029	Aa2/AA+/AAA
Sewage 2003-B	150,000,000	5/22/2003	4.14	BMA	4,737,686	7/1/2033	7/1/2033	Aa2/AA+/AAA
Sewage Hedge Swap	125,000,000	9/1/2006	4.96	BMA	21,213,900	7/1/2036	N/A	Aa2/AA+/AAA

(1) Notional amount balance as of July 1, 2005

(2) The Bond Market Association Municipal Swap Index™

(3) Denotes the the swap termination date does not match the final maturity of the financings

positive, the Fund would be exposed to credit risk in the amount of the derivatives' positive fair value.

The swap agreements contain varying collateral agreements with the counterparties. The swaps require full collateralization of the fair value of the swap should the counterparty's credit rating fall below certain rating levels by Fitch Ratings, Standard & Poor's, and/or Moody's Investors Service. Collateral on all swaps is to be in the form of U.S. government securities held by a third-party custodian.

Basis risk. The Fund is not exposed to significant basis risk on its swaps because most of the variable payments received are based on the Bond Market Association (BMA) index. The Consumer Price Index (CPI) indexed swaps are associated with CPI indexed financings and thus create no basis risk. The London Interbank Offered Rate (LIBOR)-based swap has basis risk on \$28.3 million of swaps.

Termination risk. The Fund or counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. In such cases, the Fund may owe or be due a termination payment, depending on the value of the swap at that time. In addition, the Fund is exposed to termination risk, but not termination payments, on certain of the Fund's swaps related to Sewer Series 1998-A, Sewer Series 1998-B, Sewer Series 2001-C-1, Sewer Series 2001-C-2, and Sewer Series 2003-B. These swaps provide the counterparty with the option to terminate the swap agreement beginning on January 1, 2010, July 2, 2011, July 1, 2005, July 1, 2005, July 1, 2008, July 1, 2008, January 1, 2010, January 1, 2010, and July 1, 2013, respectively, upon the passing of certain BMA thresholds. If any of these swaps were terminated, the associated variable-rate financings would no longer carry synthetic interest rates, but there would be no termination payment.

Rollover risk. The Fund is exposed to rollover risk on swaps that mature or may be terminated prior to the maturity of the associated financings. When these swaps terminate or, in

the case of the termination option, if the counterparty exercises its option, the Fund will not realize the synthetic rate offered by the swaps on the underlying issues.

(10) Employee Benefit Plan

Substantially all City employees, including the Sewage Disposal Fund employees, are covered by a single-employer plan composed of a defined benefit with an optional employee-contributed annuity through the General Retirement System (GRS). The GRS pays a monthly pension to qualified individuals upon retirement. The amount is based upon a combination of years of service and annual salary.

Plan Description

The GRS is administered in accordance with the City of Detroit Charter and union contracts, which assign the authority to establish and amend contributions and benefit provisions to the Retirement System's board of trustees. The GRS issues separate, stand-alone financial statements annually. Copies of these financial statements can be obtained at the Coleman A. Young Municipal Center, 2 Woodward Ave., Rm. 908, Detroit, Michigan, 48226.

Funding Policy

The GRS funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. The contribution requirements are established and may be amended by the GRS board of trustees based on information provided by the GRS's consulting actuary. The City's contribution is set by the City Council in conjunction with its approval of the City's annual budget based on information provided by the GRS's consulting actuary.

The recommended contribution rate is determined by the GRS's consulting actuary using the entry age normal actuarial cost funding method. Significant actuarial assumptions used to compute contribution requirements

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

are the same as those used to compute the actuarial accrued liability.

Based upon the June 30, 2003 actuarial valuation, which was the most recent actuarial data available when the budget was developed for the year ended June 30, 2005, the actuary recommended the Sewage Disposal Fund contribution rate of 10.09%. Contributions for the Sewage Fund totaled \$14,210,003, which included \$8,474,165 from

proceeds of the issuance of the pension obligation certificates of participation (see note 11).

Employees may elect to contribute 3%, 5%, or 7% of the first \$87,900 of annual compensation and 5% or 7% of any excess over \$87,900 for annuity savings. Contributions are voluntary for all union and nonunion employees. Contributions received from Sewer Fund employees during the year ended June 30, 2005 amounted to \$6,108,640.

(10) - Administrative Expenses

	<u>Fiscal year ended</u>	<u>Annual pension cost (APC)</u>	<u>Percentage of APC contributed</u>	<u>Net pension asset</u>
General Retirement System	June 30, 2003	\$ 1,569,978	100%	\$ —
	June 30, 2004	2,559,591	100	—
	June 30, 2005	6,359,722	223	7,850,281

(10) - Following are the annual pension cost and net pension asset as of June 30, 2005

Annual required contributions	\$ 6,359,722
Interest on net pension asset	—
Adjustment to annual required contribution	—
Annual pension cost	6,359,722
Contributions made (employer)	14,210,003
Changes in net pension asset	7,850,281
Net pension asset, beginning of year	—
Net pension asset, end of year	\$ 7,850,281

(10) - The actuarial methods and significant assumptions used to determine the annual required contributions for June 30, 2005 were as follows:

Valuation date	June 30, 2003
Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period	15 years
Asset valuation method	3-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.90%
Projected salary increases*	4% – 9.5%
Cost-of-living adjustments*	2.25%

*Includes inflation rate of 4%

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

Administrative Expenses

Actuarial investment management and bank trustee fees and expenses are included in the GRS plan's administrative expenses when incurred. In addition, the GRS plan's administrative salary, rent, accounting services, duplicating, telecommunications, and travel expenses are included in the GRS plan's administrative expenses when incurred. See charts page 48.

(11) Due (to) from Other Funds

During the course of operations, numerous transactions occur between individual funds and other City of Detroit funds for goods provided or services rendered. Related receivables and payables are classified as "due from other funds" or "due to other funds" on the balance sheets and are summarized. See chart below.

(12) Capital Improvement Programs

The Fund is engaged in a variety of projects that are a part of its five-year Capital Improvement Program (the Program). The total cost of this Program is anticipated to be approximately \$1.95 billion through fiscal year 2010. The Program is being financed primarily from revenues of the Fund and proceeds from the issuance of revenue bonds.

The total amount of construction contract commitments outstanding at June 30, 2005 and 2004 was approximately \$453 million and \$647 million, respectively.

(13) Rate Adjustments

The U.S. Environmental Protection Agency (EPA), in attempting to ensure that user charges are proportional in

effect as well as in their design, requires grantees to compare budgeted wastewater contributions, revenues from users, and user classes to actual results and make appropriate rate adjustments in the second succeeding year. The accompanying financial statements reflect management's estimates of the current and noncurrent amounts receivable from and refundable to customers in accordance with the regulations. Although subsequent adjustments to these amounts may occur, management does not believe the impact would be material to the Fund's financial position or results of operations.

(14) Contingencies

The operation of the Fund's Waste Water Treatment Plant (WWTP) is subject to extensive regulation pursuant to the Federal Water Pollution Control Act, as amended by the Clean Water Act of 1977 and the Water Quality Act of 1987 (collectively, the Clean Water Act). Included in the regulatory framework established by the Clean Water Act is the National Pollutant Discharge Elimination System (NPDES) permit program, which requires operation of wastewater treatment facilities according to discharge limitations and other requirements as set forth in permits issued to each facility. The U.S. EPA has authorized the State of Michigan Department of Environmental Quality (MDEQ) to implement and enforce the federal NPDES permit program.

The Fund and the City's Legal Department operate the WWTP pursuant to an NPDES permit that took effect on January 1, 2004 and which is due to expire on October 1, 2007.

(11) - Due (to) from Other Funds

	2005	2004
Due from other funds (unrestricted):		
General	\$ 11,887,394	12,791
Water	54,500,684	40,401,103
Total due from other funds	\$ 66,388,078	40,413,894
Due from other funds (restricted):		
General	\$ 37,355,552	15,584,333
Water	282,997	5,104,477
Total due from other funds	\$ 37,638,549	20,688,810
Due to other funds (unrestricted):		
General	\$ 4,921,074	7,508,820
Water	48,212,647	27,166,286
Total due to other funds	\$ 53,133,721	34,675,106
Due to other funds (restricted):		
General	\$ 48,509	48,509
Water	11,025,493	5,158,637
Total due to other funds	\$ 11,074,002	5,207,146

CITY OF DETROIT SEWAGE DISPOSAL FUND

Notes to Financial Statements June 30, 2005 and 2004

The Fund is also a defendant in numerous other alleged claims and lawsuits. The Fund and its legal counsel have estimated a reserve for the potential outcome of such claims or the amount of potential damages in the event of an unfavorable outcome for each of the above contingencies, which is included in the accompanying financial statements. The Fund's management and the City's Legal Department estimate that any differences in reserved amounts, and other potential claims against the Fund not covered by the Fund's insurance, resulting from such litigation will not materially impact the Fund's financial position or results of operations.

The City holds various commercial insurance policies to cover potential loss exposures.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress (in thousands) for the General Retirement System (unaudited):

<u>Actuarial valuation date, June 30</u>		<u>Actuarial value of assets</u>	<u>Actuarial accrued liability (AAL)</u>	<u>Funded ratio</u>		<u>Unfunded AAL (UAAL)</u>	<u>Covered payroll</u>	<u>UAAL as a percentage of payroll</u>
2001	\$	303,601	212,534	142.85%	\$	(91,067)	44,300	(205.57)
2002		272,374	220,094	123.75		(52,280)	45,000	(116.18)
2003		215,039	222,870	96.49		7,831	45,000	17.40



For more information, contact the:
Public Affairs Division
735 Randolph Street, Suite 1001
Detroit, Michigan 48226-2830
313.964.9460 Office
313.964.9370 Fax
www.dwsd.org